BRIEF IN SUPPORT OF PETITION.

POINTS AND AUTHORITIES.

I. A TAXPAYER, IN ORDER TO ESTABLISH A DEDUCTIBLE LOSS, MUST OFFER CLEAR AND CONVINCING PROOF.

Burnet v. *Houston*, 283 U. S. 223, 227.

New Colonial Ice Co. v. *Helvering*, 292 U. S. 435, 440.

U. S. Treasury Department, Bureau of Internal Revenue, Regulation 77, Article 171.

U. S. v. *S. S. White Dental Mfg.* Co., 274 U. S. 398.

Ewing Thomas Converting Co. v. *McCaughn*, 43 F. (2) 503, 505.

II. THE EVIDENCE IN THIS CASE SHOWED BEYOND DISPUTE THAT THE FACTS SUBSISTING UNTIL THE YEAR 1934 DID NOT CONSTITUTE CLEAR AND CONVINCING PROOF BUT, ON THE CONTRARY, GAVE RISE TO OPPOSING AND CONFLICTING INFERENCES, SUCH THAT THE TAXPAYER COULD NOT HAVE ESTABLISHED THAT THE LOSS WAS SUSTAINED IN 1933 (THE YEAR SELECTED BY THE COMMISSIONER AND BOARD OF TAX APPEALS) OR ANY OTHER YEAR PRIOR TO 1934.

Appeal of Williamson Milling Co., 5 B. T. A. 814, 818.

Brill v. *Commissioner*, 20 B. T. A. 495.

Ladew v. *Commissioner*, 22 B. T. A. 443.

Lyon v. *U. S.*, 5 Fed. Supp. 138, 139.

Lawson v. *Commissioner*, 42 B. T. A. 1103.

III. THE BOARD OF TAX APPEALS AND THE CIRCUIT COURT OF APPEALS ERRONEOUSLY RULED THAT EVIDENCE WHICH WOULD NOT HAVE ENTITLED TAXPAYER TO ESTABLISH THE LOSS IN 1933, WAS SUFFICIENT TO WARRANT THE COMMISSIONER AND THE BOARD OF TAX APPEALS IN FINDING THAT THE LOSS WAS SUSTAINED IN THAT YEAR.

(See argument.)

IV. PETITIONER PROVED THE ORIGINAL COST OF THE STOCK AND FACTS WHICH WOULD HAVE PREVENTED HIM FROM DETERMINING THAT THE LOSS WAS SUSTAINED IN ANY YEAR PRECEDING 1934. THIS WAS SUFFICIENT PROOF THAT THE PERTINENT PROPERTY HAD A VALUE IN THE YEAR 1933.

(See argument.)

V. THE PERTINENT STATUTORY PROVISIONS AS CONSTRUED BY THE CIRCUIT COURT OF APPEALS VIOLATE THE INHIBITIONS OF THE FIFTH AMENDMENT OF THE CONSTITUTION OF THE UNITED STATES.

(See argument.)

VI. CONCLUSION.

84 University of Pennsylvania Law Review, p. 41.

ARGUMENT.

I. A TAXPAYER, IN ORDER TO ESTABLISH A DEDUCTIBLE LOSS, MUST OFFER CLEAR AND CONVINCING PROOF.

In those cases where the sole issue presented is whether the taxpayer sustained a loss so as to authorize him to take a deduction in his income tax return, it has been held that such deductions from gross income, being matters of legislative grace, must *clearly* come within the conditions prescribed by the statute. *Burnet* v. *Houston*, 283 U. S. 223, 227; *New Colonial Ice Co.* v. *Helvering*, 292 U. S. 435, 440. Treasury regulations have provided that losses "must usually be evidenced by closed and completed transactions." Art. 171, Reg. 77. This court has said that such losses may usually be fixed by identifiable events. *U. S.* v. *S. S. White Dental Mfg. Co.*, 274 U. S. 398, 401. The rationale of the decisions on the subject is all to the effect that such deductions, being matters of grace, must be clearly established by the taxpayer by definite and precise evidence. If he fails to do that his claim for a deduction falls. *Burnet* v. *Houston*, 283 U. S. 223, 227.

II. THE EVIDENCE IN THIS CASE SHOWED BEYOND DISPUTE THAT THE FACTS SUBSISTING UNTIL THE YEAR 1934 DID NOT CONSTITUTE CLEAR AND CONVINCING PROOF BUT, ON THE CONTRARY, GAVE RISE TO OPPOSING AND CONFLICTING INFERENCES, SUCH THAT THE TAXPAYER COULD NOT HAVE ESTABLISHED THAT THE LOSS WAS SUSTAINED IN 1933 (THE YEAR SELECTED BY THE COMMISSIONER AND BOARD OF TAX APPEALS) OR ANY OTHER YEAR PRIOR TO 1934.

Here, there was no question whether the petitioner sustained a loss—that was not an issue. The petitioner claimed that within the meaning of the Revenue Act he sustained his loss in 1934; the Commissioner contended that the loss was sustained in an earlier year—1933. The issue thus posed for the determination of the Board of Tax Appeals was not quite the same as in the conventional loss case, for, implicit in the Commissioner's disallowance of the deduction in 1934, on the ground that it was sustained in 1933, lies the contention that during 1933 events had taken place, which were either "closed transactions" or "identifiable events" having such an air of finality and precision that they fixed that year as the year in which petitioner's loss was sustained. Thus, it is submitted, a burden which normally rests on the taxpayer in the conventional loss case was assumed, by the very nature of his determination, by the Commissioner in this case. *And, to sustain his determination, the Commissioner should be able to point to evidence of occurrences during 1933 having such finality and precision that they identified that year as the year in which the loss was sustained—evidence so definite that it bound the taxpayer to take the loss in that year, and would have sustained the taxpayer had he claimed the loss in his return for that year.*

But here the evidence for that year is evenly balanced. Conflicting and opposing inferences can be reasonably

drawn therefrom. Petitioner submits that the presumption of correctness which usually attends the determination of the Commissioner cannot, on the issue before the Board of Tax Appeals in this case, be availed of to supply something the evidence lacks. *If that were the case, a taxpayer would have to judge occurrences not by what they mean in law, but by what an administrative official might think they indicate.*

Under such interpretation of the law a taxpayer would always be at the mercy of the Commissioner in situations like that involved in this case. The taxpayer could not take a loss in any year in which, in the opinion of the Commissioner, there was not *clear and convincing proof;* nor could he take it in any year later than the one in which the Commissioner ruled that the *weight of the evidence* established that the loss was incurred.

III. THE BOARD OF TAX APPEALS AND THE CIRCUIT COURT OF APPEALS ERRONEOUSLY RULED THAT EVIDENCE WHICH WOULD NOT HAVE ENTITLED TAXPAYER TO ESTABLISH THE LOSS IN 1933, WAS SUFFICIENT TO WARRANT THE COMMISSIONER AND THE BOARD OF TAX APPEALS IN FINDING THAT THE LOSS WAS SUSTAINED IN THAT YEAR.

In this case, tersely stated, the Commissioner pointed to: (1) the formation and operation of a creditors' committee (R. 93); (2) the curtailment of business operations; (3) voluntary settlements with trade and bank creditors (R. 83, 85); (4) a letter from the president of the corporation to its shareholders (R. 78); and (5) the delisting of the stock from an exchange list (R. 17), as indicative of the fact that the stock owned by the petitioner had in fact become worthless during 1933. *But both the Commissioner and the Board, it is submitted, have given an erroneous probative effect to such evidence. As a matter of law, it is submitted that a trier of the fact can only find a threat of*

ultimate loss,—and not present loss,—from such facts. The mere fact that a receivership has been in control of the business is not sufficient to prove the worthlessness of an investment. *Appeal of Williamson Milling Co.*, 5 B. T. A. 814, 818. An irregular adjudication in bankruptcy does not indicate worthlessness in the year of the adjudication. *Brill* v. *Commissioner*, 20 B. T. A. 495. The fact that a corporation is in the hands of a creditors' committee for three years prior to actual liquidation does not establish worthlessness. *Ladew* v. *Commissioner*, 22 B. T. A. 443. The appointment of a receiver, or even a showing of bankruptcy, is not sufficient to entitle a taxpayer to deduct the cost of the stock as worthless. *Lyon* v. *U. S.*, 5 Fed. Supp. 138, 139. *These decisions all hold that the evidence relied on by the Commissioner foreshadows possible ultimate loss, but does not identify a present loss.*

Furthermore, the foregoing facts were opposed and rebutted by (1) activities of the corporate officers (in which petitioner participated) during 1933 contemplating a possible reorganization of the company—admittedly never achieved (R. 34); (2) the existence during 1933 of a small over-the-counter market in the Studebaker Mail Order stock at prices ranging from ten to twenty-five cents per share (R. 27, 28); (3) the fact that, although there was a deficiency in the balance sheet, the corporation at the close of 1933 was possessed of accounts receivable in the face amount of $580,000 (which the undisputed evidence showed had some value after 1933) (R. 37, 38, 44, 45), with no debts to speak of; (4) the retention of an oral option good until 1934, to reacquire corporate real estate conveyed during 1933 to the bank creditors (R. 20, 21); and (5) a certain intangible good will value arising out of the name "Studebaker" (R. 22, 43). These events, petitioner submits, as a matter of law, placed the year 1933 in a state of balance. *Since reasonable-minded individuals might draw contrary inferences from all the evidence with respect to that year,*

the petitioner was therefore not clearly entitled to take the loss at the close of 1933. Conversely, the Commissioner is likewise bound. *The true burden, and the only burden, resting on the petitioner at the hearing before the Board of Tax Appeals was that of showing this balancing of the facts and it was sufficient as a matter of law to rebut the correctness of the Commissioner's determination of a deficiency.* In other words, by showing the *absence* of *closed transactions* and the *absence* of identifiable events in 1933 the taxpayer had sufficiently rebutted the correctness of the Commissioner's determination as a matter of law to entitle him to have the propriety of his return accepted.

IV. PETITIONER PROVED THE ORIGINAL COST OF THE STOCK AND FACTS WHICH WOULD HAVE PREVENTED HIM FROM DETERMINING THAT THE LOSS WAS SUSTAINED IN ANY YEAR PRECEDING 1934. THIS WAS SUFFICIENT PROOF THAT THE PERTINENT PROPERTY HAD A VALUE IN THE YEAR 1933.

The Board of Tax Appeals held:

> "From the details set out in full in our findings of fact it seems apparent that petitioner's stock in the Studebaker Mail Order Company became worthless prior to 1934. Certainly the evident condition of the company, coupled with petitioner's own estimate of the value of the securities, as shown by his sales in 1933, *require the conclusion that he has failed to sustain his burden of proving that there was any value whatever remaining at any time in the year 1934* [*1933*]. On this issue respondent is sustained." (Italics supplied.)

It is submitted that the effect of that holding was to place too great a burden of proof on the petitioner in the hearing before the Board. *It is submitted further, that all petitioner needed to show, to meet the precise issue presented by the petition and the Commissioner's answer, was that the events of 1933 lacked finality and definiteness*

so as to enable or require him to take the loss at the end of that year.

Petitioner concedes that it is the function of the Board of Tax Appeals to weigh the evidence, make findings of fact, and that its decisions, when supported by substantial evidence, are to be sustained by the courts. But, whether evidence is substantial is a question to be decided by the courts, and that question must be answered with reference to the nature of the issue to which the proffered evidence be relevant. Where, as here, a determination (*i. e.,* that the loss was sustained in a prior year) requires clear and convincing evidence to support it, but is sought to be sustained by evidence which is evenly balanced, then that determination, it is submitted, is not, as a matter of law, sustained by substantial evidence within the meaning of the Revenue Act.

As illustrative of the divergent views which the Board itself draws from evidence virtually identical with that of the case at bar, we refer to the case of *Lawson* v. *Commissioner,* 42 B. T. A. 1103 (promulgated October 30, 1940, Docket No. 99,300). There the taxpayer claimed a loss for worthless stock in his return for the year 1936. The Commissioner disallowed the deduction on the ground that the stock became worthless in fact in some year prior to 1936. The evidence showed that: (1) the companies in which that taxpayer held his stock encountered financial difficulties in 1932 and a receiver was appointed for the companies during that year; (2) in 1934, proceedings for reorganization were instituted in the federal courts; (3) later, in 1934, the companies were adjudicated insolvent; (4) the financial statement of the companies showed a balance sheet deficit of $2,503,499.74 in the year 1934; (5) various plans for reorganization at first proposed to allow the taxpayer and other stockholders some stock in new companies for their stock in the insolvent companies, but in 1936 the final and approved plans for reorganiza-

tion gave the taxpayer nothing. (All of these facts are virtually identical with those of the case at bar except that there were no court proceedings for the Mail Order company.) The taxpayer claimed his loss in the year 1936. In the *Lawson* case the Board of Tax Appeals held that all of the events pointed to by the Commissioner indicated "imminence of loss, not present fact of loss," and cited in support of the Board's decision the very cases we have referred to earlier in this petition. That case is illustrative of the unjust and confusing results bound to follow from divergent views of the precise nature of the question which is presented where the Commissioner disallows a loss on the ground that the loss was in fact sustained in a *prior year*. When the Commissioner disallows a conceded loss, it is submitted that *he* assumes a burden of establishing that the events of the prior year or years were of such conclusive and definite finality that they *bound* the taxpayer to take his loss in that year.

If the decision of the Circuit Court of Appeals in this matter is sound, a taxpayer may determine that the loss has been sustained only upon *clear and convincing* proof; whereas, the Government may determine that the loss was sustained earlier by him by the *weight of the evidence*. The inevitable result will be such cases of injustice as the present one, in which the taxpayer, after acting in good faith, finds that the Government insists that he sustained the loss in a year in which he himself could not have determined it.

V. THE PERTINENT STATUTORY PROVISIONS AS CONSTRUED BY THE CIRCUIT COURT OF APPEALS VIOLATE THE INHIBITIONS OF THE FIFTH AMENDMENT OF THE CONSTITUTION OF THE UNITED STATES.

We submit that the pertinent statutory provisions, if construed in accordance with the decision of the Circuit Court of Appeals in this case, violate the inhibition of the

Fifth Amendment of the Constitution of the United States providing that "No person shall * * * be deprived of * * * property, without due process of law."

VI. CONCLUSION.

The inequities inherent in the principles underlying the decision of the Circuit Court of Appeals in this case are remarked by Professor Robert C. Brown of the Law School of Indiana University in an article in Volume 84 of Pennsylvania Law Review entitled "The Time for Taking Deductions for Losses and Bad Debts for Income Tax Purposes," from which article we quote the following apposite comment (page 41):

> "In view of the difficulty of recognizing and sometimes of even knowing about such deductions—a difficulty which confronts nearly every taxpayer more or less frequently—it would appear that these deductions should be determined at least in the first instance, upon a practical rather than a purely theoretical basis. The remark of Judge Learned Hand that 'taxes, like other human affairs, must be determined without the gift of divination,' should be given especial weight under these circumstances. This theory assumes that the taxpayer should determine, in the first instance, the proper date for taking the deduction, and that he should not be reversed by the Bureau of Internal Revenue unless his decision was not merely mistaken as it now appears (with the added advantage of hindsight), but that it was clearly unreasonable and unfair at the time at which he was compelled to make his decision. As will presently appear, however, a considerable tendency has been directly the opposite. The position of the Bureau has generally been that such deductions—at least for losses—can and must be taken by the taxpayer according to what were the *actual facts as now appearing rather than on the basis of what he knew, or could reasonably have been expected to know, at the time.* Even when it is yet a matter of real dispute, the Bureau apparently thinks

that the taxpayer is bound to know not merely all the facts but what the Bureau itself will think the facts to mean. All this is more reminiscent of medieval metaphysics than of the practical common sense which is reasonably to be expected of men engaged in the very practical activity of administering an important revenue measure in a modern and highly organized state; nevertheless, such is the actual trend. Even attempts of Congress—notably in the Revenue Acts of 1921 and 1924—to liberalize the situation as to losses to some degree have been given little weight by the Bureau, which is still generally committed to its highly metaphysical standpoint in this matter.

"However, the Board of Tax Appeals, and even more clearly the courts, have often taken a somewhat less rigid, and therefore more practical and fairer, point of view. But even these supposedly more impartial tribunals are still more or less under the influence of the same metaphysical ideas. Even yet many courts give little more than lip service to the frequently and explicitly phrased idea that taxation is a practical matter. The present statement of the Circuit Court of Appeals for the Seventh Circuit that 'the decisions do not appear always to be consistent' (*Commissioner of Internal Revenue* v. *Highway Trailer Co.*, 72 F. (2d) 913, 914 (C. C. A. 7th, 1934) rev'g 28 B. T. A. 792 (1933), is certainly far from an exaggeration of the situation." (Italics ours.)

WHEREFORE, petitioner prays that a writ of certiorari issue for the review of the decision of the Circuit Court of Appeals for the Seventh Circuit.

Respectfully submitted,

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Chicago, Illinois,
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